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Winspear Business Reference Room
University of Alberta
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Edmonton, Alberta T6G 2R6

SOUTHWARD ENERGY LTD.

1989 ANNUAL REPORT
AUGUST 31st

1812

PRESIDENTS MESSAGE

TO THE SHAREHOLDERS

During the year your company successfully accomplished the following:

- *Settlement of the law suit in which it was a defendant with complete vindication and no financial loss to the company.*

- *Completion of a property and cash exchange for some of its oil production in Willmar, Saskatchewan. In this exchange the company traded approximately 40 of its 55 barrels per day of net oil production from Willmar for $190,000 in cash along with 700 thousand cubic feet per day of gas production. The resulting impact of this transaction increased Southward's cash flow by better than $25,000 per month.*

- *Involvement in 2 Alberta gas completions, both at no cost to the company, resulting in increases in cash flow ranging from $5,000 to $15,000 per month during the next calendar year.*

- *Procured a Pan-Alberta gas contract and transportation for 3 million cubic feet (MMcf) of natural gas per day for some of its production in Athabasca, Alberta.*

- *Procured a CanCarb gas contract with transportation for 3 million cubic feet (MMcf) of natural gas per day for some of its production also in the Athabasca area.*

- *Extension of its Dow Chemical gas supply option agreement to September, 1990.*

Although our year end financial statements would suggest that the company had a poor year, we in fact have made significant progress during the calendar year of 1989. This progress is partially represented in our quarterly report also enclosed with this information package. Due to plant turnaround problems at the receipt point of our Athabasca gas wells we were restricted to only 40 days of the 90 day production period during September, October and November of this year. Even in light of this 55% cut in production our quarterly sales were 25% greater than the same period of last year. These gas wells have been on stream with nominal interruption since the beginning of November so that the company's six month quarterly statements will illustrate significant increases in cash flow.

On the operations side, the company recently negotiated a farmin opportunity on a section of land adjacent to one of the company's Athabasca gas wells. We were successful in re-farming the drilling obligations under this agreement so that Southward will be left with a 35% interest in the well after payout. This development well could be tied into a sales line immediately if successful.

Southward is currently soliciting farmin offers for our 50% interest on one and three quarters sections of crown minerals in the Majorville area of Alberta. The company anticipates farming this prospect out so that it will be left with a 25% working interest after payout of any drilling operations on these lands. This prospect is gas prone with potential sales gas recoverables on the order of 2 - 5 billion cubic feet.

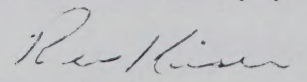
We are presently negotiating to secure another farmout covering at least two sections of land in North Central Alberta. The company's objective is to earn 100% of the minerals by drilling a development well adjacent to a well that has produced over 8 billion cubic feet of gas to date. By drilling this well additional sections of minerals could be earned. If the company is unable to obtain financing to participate directly in the operations described above, it will farmout these obligations so that it is left with a carried working interest in the project with no financial exposure.

Southward's exploration staff has several new prospects that require seismic and land acquisition expenditures to expose the company to added drilling opportunities. These expenditures will be made from equity financings or joint venture associations if equity funds are not available.

Although Southward's exploration budget has been limited during the last two years, the company continues to generate and farmout prospects in order to enjoy no cost exposure to highly prospective natural gas opportunities.

Even though our common shares trade in the 10 - 20 cent range, Southward's breakup approximates 50 cents per share. We believe that as our financial statements document our most recent financial improvement our stock prices will reflect the company's true value.

Submitted on behalf of the Board



R.W. Kiser
President

AUDITORS' REPORT

To The Shareholders
Southward Energy Ltd.

I have examined the consolidated balance sheet of Southward Energy Ltd. as at August 31, 1989, and the consolidated statements of operations and deficit and changes in financial position for the year then ended. My examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, these financial statements present fairly the financial position of the company as at August 31, 1989, and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
December 14, 1989

John Geib
Chartered Accountant

SOUTHWARD ENERGY LTD.
Consolidated Balance Sheet
August 31, 1989

	1989	1988
ASSETS		
Current		
Cash held in trust	$ -	$ 54,000
Accounts receivable	40,590	78,545
Prepaids	1,500	-
	42,090	132,545
Fixed (Note 2)	1,202,284	1,200,243
	$ 1,244,374	$ 1,332,788
LIABILITIES		
Current		
Bank indebtedness (Note 3)	$ 261,379	$ 150,687
Accounts payable and accrued	133,451	226,820
Convertible debentures (Note 4)	200,000	165,000
Promissory notes (Note 5)	50,000	-
	644,830	542,507
Convertible debentures (Note 4)	88,800	188,800
Bank indebtedness (Note 3)	133,462	-
SHAREHOLDERS' EQUITY		
Share capital (Note 6)	1,498,029	1,498,029
Deficit	(1,149,883)	(923,215)
Cumulative translation gain	29,136	26,667
	377,282	601,481
	$ 1,244,374	$ 1,332,788

ON BEHALF OF THE BOARD:

Richard W. Kiser - Director

Scott W. Kiser - Director

SOUTHWARD ENERGY LTD.
Consolidated Statement of Operations and Deficit
For the year ended August 31, 1989

	1989	1988
Revenue		
Petroleum and Natural Gas sales	$ 392,796	$ 408,570
Royalties	131,315	131,324
	261,481	277,246
Operating	5,433	30,169
Interest earned	7,517	388
	274,431	307,803
Direct expenses		
Operating	63,109	48,922
Depletion and depreciation	79,663	95,869
Revenue from operations	131,659	163,012
Other expenses		
General and administrative	255,672	216,337
Interest and bank charges	37,907	13,786
Debenture interest	40,000	34,495
Share issuance costs	-	10,000
Interest on settlement of debt	24,748	-
	358,327	274,618
Loss for the year	226,668	111,606
Deficit, beginning of year	923,215	811,609
Deficit, end of year	$ 1,149,883	$ 923,215
Net loss per share	$ .09	$ .04

SOUTHWARD ENERGY LTD.
Consolidated Statement of Changes in Financial Position
For the year ended August 31, 1989

	1989	1988
Operating Activities		
Loss for the year	$ (226,668)	$ (111,606)
Charges (Credits) to income not requiring cash:		
Effect of exchange rate changes on working capital	2,469	(5,413)
Depreciation and depletion	79,663	95,869
Commissions on stock sale	–	10,000
	(144,536)	(11,150)
Net change in non-cash working capital balances related to operations	(2,914)	41,522
	(147,450)	30,372
Financing Activities		
Repayment of Debentures	(65,000)	-
Issuance of debentures	-	88,800
Proceeds of long term debt	133,462	-
Proceeds of promissory note	50,000	-
	118,462	88,800
Investing Activities		
Geological costs capitalized	(72,732)	(70,206)
Effect of exchange rate changes on fixed assets	2,339	2,965
Exploration and lease acquisition	(311,287)	(183,312)
Government grants	8,136	9,399
Proceeds of sale of petroleum and natural gas properties	296,307	93,139
Acquisition of office assets	(4,467)	(11,948)
	(81,704)	(159,963)
Changes in cash during the year	(110,692)	(40,791)
Cash at beginning of year	(150,687)	(109,896)
Cash at end of year *	$ (261,379)	$ (150,687)

* Cash at end of year consists of short-term7 bank borrowings less cash.

SOUTHWARD ENERGY LTD.
Notes to the Consolidated Financial Statements
For the year ended August 31, 1989

1. Summary of Significant Accounting Policies

Southward Energy Ltd. is a publicly traded company engaged in the oil and gas business and is incorporated under the Alberta Business Corporations Act. These financial statements are prepared in accordance with generally accepted accounting principles, the more significant of which are:

a) Consolidation

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiary, Southward Resources Inc.

b) Oil and gas operations

The company follows the full cost method of accounting in accordance with the guideline issued by The Canadian Institute of Chartered Accountants whereby all costs associated with the exploration for, and development of, oil and gas reserves, whether productive or unproductive, are capitalized in cost centers. Such costs include land acquisition, drilling, geological and geophysical expenses related to exploration and development activities.

Gains or losses are not recognized upon the disposition of oil and gas properties unless such a disposition would change the depletion rate by 20% or more. Gains and losses are recognized upon the disposition of other assets.

Carrying values of oil and gas properties and share capital are reduced by grants received and transferred to flow through share-holders. Other grants earned under various government incentive programs are accrued and applied against the related expenditures.

c) Depreciation and depletion

Furniture and fixtures are depreciated on a 20% declining balance basis. Tangible equipment, oil and gas properties and intangibles are depleted on the unit of production method, based on proven reserves of oil and gas as determined by independent engineers and management's estimates. Natural gas reserves are converted to equivalent barrels of oil based upon the relative energy content of each product. In calculating depletion, gross proven reserves (before royalties) are used. Cost centers for purposes of calculating depletion are segregated between Canada and the United States.

d) Ceiling limitations

The net carrying value of the company's oil and gas properties is limited to an ultimate recoverable amount which is the aggregate of future net revenues from proved reserves and the costs of unproved properties net of impairment allowances, less future operating costs. Future net revenues are estimated using year-end prices discounted at 15%.

SOUTHWARD ENERGY LTD.
Notes to the Consolidated Financial Statements (Cont.)
For the year ended August 31, 1989

1. Summary of Significant Accounting Policies (Cont.)

e) Income taxes

The company accounts for income taxes by the tax allocation method, whereby income tax expense is determined as the amount that would be payable if statutory tax deductions for drilling, exploration and property acquisition costs and for capital cost allowances were claimed for tax purposes at the same rate as the related depletion and depreciation provisions charged against income.

f) Foreign currency translation

The company translates the accounts of the U.S. subsidiary to Canadian dollars by translating the balance sheet at the rate in effect at the year-end date. The statement of operations is translated at the average rate for the year. The effect of the translation is included in shareholders' equity.

2. Fixed, at Cost

	1989	1988
Petroleum and Natural Gas properties	$ 1,689,495	$ 1,616,049
Furniture and equipment	49,079	44,612
	1,738,574	1,660,661
Less accumulated depletion and depreciation	536,290	460,418
	$ 1,202,284	$ 1,200,243

The company has unused cumulative Canadian oil and gas property expense of $309,381, cumulative Canadian development expense of $123,382, cumulative Canadian exploration expense of $658,857 and earned depletion of $54,610, available to reduce future taxable income.

3. Bank Indebtedness

Bank indebtedness is payable on demand and is comprised of the following:

Overdraft	$ 99,841
Treasury Branch loan - revolving	120,000
Treasury Branch term loan	175,000
	394,841
Less current portion	261,379
	133,462

A floating charge debenture in the principal amount of 250,000, a continuing guarantee and postponement of claim to the corporation by the Company's president, and a general assignment of book debts are pledged as collateral against the indebtedness. The debenture carries an interest rate of prime plus 3%. Letters of guarantee from various individuals aggregating $120,000 are also pledged as collateral against the revolving loan.

The revolving loan bears interest at prime plus 1% and the term loan at prime plus 1 1/2%. Interest is payable monthly.

3. Bank Indebtedness (Cont.)

The revolving loan requires periodic principal payments as determined by management. Management has indicated that no payments are anticipated for fiscal 1990 and accordingly the entire amount has been classified as long term. The term loan requires monthly principal payments of $13,462. Accordingly $13,462 has been classified as long term.

4. Convertible Debentures

12% debentures: a floating charge subordinated to the bank is pledged as collateral for the debentures. Interest is payable quarterly. The debentures are convertible to common shares at a price of 66.67 cents per share. The debentures are repayable December 15, 1989 if not converted before then.	$	100,000
10% debentures: these amounts are unsecured. Interest is payable on maturity. The debentures are convertible to common shares at a price of 50 cents per share. The debentures are repayable April 30, 1989 if not converted before then.	$	100,000
10% debentures: a floating charge subordinated to the bank is pledged as collateral for the debentures. Interest is payable quarterly. The debentures are convertible to common shares at a price of 60 cents per share. The debentures are repayable February 28, 1991, if not converted before then.	$	88,000
	$	288,800
Less current portion	$	200,000
	$	88,800

The 10% debentures repayable April 30, 1989, were paid off subsequent to the Company's year end.

SOUTHWARD ENERGY LTD.
Notes to the Consolidated Financial Statements (Cont.)
For the year ended August 31, 1989

5. Promissory Notes

The promissory notes are unsecured and bear interest at 12% per annum. One note in the amount of $20,000 was paid November 30, 1989. The second note of 30,000 is repayable at the end of December 1989. Both notes are payable to the Company's president for funds advanced March 28, 1989.

6. Share Capital

	1989	1988
Authorized		
20,000,000 common shares without nominal or par value		
Issued		
2,577,780 shares (1988 - 2,577,780)	$ 1,489,029	$ 1,489,029

On June 7, 1989 there were stock options issued in respect of 255,000 common shares exercisable at 20 cents per share. All of the options expire December 31, 1991 and were granted to directors and employees of the company.

7. Related Party Transactions

During the year, the company paid remuneration to, officers and/or directors or their nominees in the amount of $109,000 (1988 - 99,876). During the year the Company purchased an interest in an oil and gas property from its president for $16,000. The Company also allowed certain directors and employees to participate in a Company drilling prospect for an aggregate total of $5,000. Both transactions were consummated at fair market value.

8. Segmented Information

The company conducts its petroleum and natural gas activities in Canada and the United States. Details of significant financial statement items are as follows:

	1989		
	Canada	United States	Consolidated
Net loss (income)	$230,860	$(4,192)	$226,668
Identifiable assets	$1,206,764	$37,610	$1,244,374
Capital expenditures	$384,019	------	$384,019

	1988		
	Canada	United States	Consolidated
Net loss (income)	$128,000	$(16,394)	$111,606
Identifiable assets	$1,288,953	$43,835	$1,332,788
Capital expenditures	$254,839	$10,637	$265,476

9. Income Tax

As at August 31, 1989 the company had losses for income tax purposes in the amount of $238,855 which are available to reduce future years' taxable income. The losses and their respective years of expiry are as follows:

1990	$	23,984
1991		14,363
1992		80,508
1993		120,000
	$	238,855

SOUTHWARD ENERGY LTD.
ANNUAL REPORT - CORPORATE INFORMATION

OFFICERS
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Scott W. Kiser
Secretary Treasurer

DIRECTORS
Richard Wayne Kiser
Scott W. Kiser
Ronald W. Ambrose
Gerald C. Saunders

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TRADING SYMBOL
SWN

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